



PENSION INSURANCE
CORPORATION

FSA Letter to Life Assurors

The issue of increasing life expectancy recently prompted The Pensions Regulator to call on corporate pension funds to strengthen their longevity assumptions and set aside more money for longer term pension payments. Now life assurers have come under the spotlight, after the FSA has written to them to express its concern that they may not be giving sufficient weight to the possibility of policyholders living longer than expected.

The FSA has called for companies to err on the side of caution, and include an 'appropriate' margin for prudence. However, life assurers are already more prudent than pension funds, setting aside solvency capital to back up their pension promises. Given that the vast majority of corporate sponsors of defined benefit schemes make far less conservative longevity assumptions than life assurers, they are likely to come under renewed pressure to fall into line.

The FSA is also concerned that the medium cohort projection, devised by the Continuous Mortality Investigation Bureau in 2002 and used by life offices for forecasting future longevity improvements, may already be out of date. But worryingly, few corporate pension sponsors use even this medium projection.

Research by Lane Clark & Peacock as recently as 2006 showed that out of 33 UK companies disclosing detailed mortality assumptions, only two were using the medium cohort projection. The other 31, or a staggering 94% of the total, were still using longevity assumptions that pre-dated even the medium cohort projection. As a result, for a man aged 60 most companies were predicting five years lower life expectancy than the medium cohort projection.

In fact, assumptions vary greatly among both corporate sponsors and life assurers. In 2006 Punter Southall, the consulting actuary showed that while the average life insurer estimated that a 65-year-old would live for a further 23 years, Marks & Spencer used a longevity estimate of 18.8 years, Imperial Tobacco 18.4 years and Tesco 17.5 years.

Challenging companies to raise their longevity expectations could lead to a huge hole in some corporate balance sheets. Recent research by Pension Capital Strategies and Numis Securities showed that the reported pension deficits of FTSE 100 companies would balloon from £20bn to £80bn if blue-chip companies stopped "underestimating future life expectancy by two to four years".

Every year difference on longevity assumptions adds around 4% to liabilities, which could equate to as much as £32bn, if UK pension scheme liabilities are believed to be around £800bn in total. These include BT (£38.1bn), Royal Dutch Shell (£30.7bn) and Royal Bank of Scotland (£20.9bn).

Any move by corporate sponsors to raise longevity forecasts could breathe life into the pension insurance market. Insurers typically charge around a 30% premium above FRS17 valuation to take a pension scheme off the hands of a sponsor. PIC estimate that a third of this premium results from differing longevity assumptions, suggesting that the true cost of buy-out is less than the headline price.